

Via E-Mail

November 13, 2018

Customer Choice Project Team
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Re: Shell Energy North America (US), L.P. Comments on Draft “Gap Analysis”

To: Customer Choice Project Team:

Shell Energy North America (US), L.P. (“Shell Energy”) submits its comments on the draft “Gap Analysis” that was posted on the Commission’s website on October 23, 2018. The draft Gap Analysis states that the Customer Choice Project team “looked at the critical policy issues associated with increased disaggregation of load and supply and conducted an internal analysis to identify the regulatory gaps that exist and the necessary actions to ensure the core principals -- decarbonization, reliability, and consumer protection -- outlined by the Choice Project are met.” Draft at p. 3. The draft Gap Analysis focuses on three categories of issues to be considered by the Commission: “consumer protection;” “duty to serve;” and “energy procurement reliability.” Id.

I.

INTRODUCTION

All of the issues identified in the draft Gap Analysis are important to a properly functioning competitive retail market. The Commission should not use these issues as an excuse, however, to deny or delay expansion of customer choice. The draft Gap Analysis contains much unnecessary hand-wringing over the transition to a de-centralized retail sales market. All of the cited issues either have been addressed by the Commission, are being addressed in ongoing proceedings, or can be addressed by the Commission through one or more new rulemaking proceedings (“OIR”). The Commission should not allow its concern over these “gap” issues to prevent customers from enjoying the benefits of choice.

II.

CONSUMER PROTECTION

The Staff's expressed concerns about "consumer protection" under the direct access program have been addressed comprehensively by the Commission with rules that apply to energy service providers ("ESP"). These rules include detailed disclosure requirements (for ESPs that serve residential load) and verification protocols that discourage "predatory sales tactics" by ESPs. Existing rules also address the process by which customers may complain to the Commission (or through other means) about ESP conduct.

More recently, the Commission adopted similar consumer protection rules for Core Transport Agents ("CTA") under the core (gas) aggregation program. The Commission does not need to revisit these rules. Expansion of direct access (and expansion of core aggregation, for that matter) can proceed without revisiting the consumer protection rules.

If the Commission plans to revisit its consumer protection rules, however, the Commission should establish a clear distinction between the consumer protection rules that apply to ESPs and CTAs that serve residential customers, and the consumer protection rules that apply to ESPs and CTAs that serve commercial, industrial and agricultural (business) customers. Business customers are sophisticated and knowledgeable about commercial terms and risk allocation. Business customers seek creative energy service solutions, and are capable of entering into commercial relationships that reflect their business needs. The Commission should not establish consumer protection rules that unnecessarily limit or intrude upon the commercial options that can be negotiated between an ESP (or a CTA) and its business customers.

The comments by Microsoft representative Emily Watt at the October 29, 2018 en banc hearing are instructive in this regard. Ms. Watt noted that all business customers have different energy needs and risk profiles. Competitive choice allows customers to achieve the State's (and internal corporate) GHG emission reduction goals in their own unique way, while managing cost and risk.

Of particular interest to the Commission should be Ms. Watt's comment that customer choice in energy can be the "economic growth engine" for California. This statement highlights the desirability of moving swiftly to open up the market to direct access and increased customer choice.

III.

DUTY TO SERVE

With regard to the "duty to serve," the Commission (and possibly the Legislature) must address the Provider of Last Resort ("POLR") issue. This comment should not come as a surprise to the Commission or Commission Staff. Numerous parties, including Shell Energy,

have raised the POLR issue for several years, in various proceedings and forums. It is time for the Commission to step up and address the POLR issue through a new OIR.

In a new OIR proceeding, the Commission should address the procurement obligation of a POLR, the timing and the fees associated with customers switching to and from a POLR, assignment of IOU procurement assets to the POLR, allocation of POLR procurement costs among “default” customers, and of course the qualifications (including creditworthiness) of any entity serving in the role of a POLR in an IOU’s service territory.

Rather than fret about the POLR issue, the Commission should institute an OIR proceeding expeditiously to tackle the issues related to establishing a POLR. In the OIR, the Commission should announce a policy that over a defined period of time, the IOUs will exit the energy procurement business. The Commission should address, in the OIR, any modifications to the affiliate transaction rules that may be necessary to allow IOU affiliates to participate in the retail sales market, as well as allow IOU affiliates to participate in the bid process to serve as a POLR. This new OIR should not delay the expansion of direct access, however. Direct access can and should be expanded to the fullest extent authorized in SB 237 while the Commission considers what entity (entities) may serve as a POLR in the future.

The draft Gap Analysis states that “[a]s customer load becomes increasingly disaggregated, designated entities must be ready to provide electricity if the market does not meet customer demand due to a sudden exit or failure of an LSE.” Draft at p. 21. This is indeed a key role of a POLR. In its OIR addressing the parameters of the POLR structure, the Commission should address the qualifications necessary to perform the POLR function, the terms and conditions of POLR service, and the other issues identified at pages 22-23 of the draft Gap Analysis.

Contrary to concerns expressed by Commissioners at the en banc hearing, however, increased disaggregation of customer load, and corresponding de-centralization of energy and capacity procurement, will not jeopardize the reliability of service to customers. The Commission should not conclude, for example, that disaggregation of the procurement of energy, RA capacity and RPS resources will lead to a less secure energy resource base.

The draft Gap Analysis expresses concern that an ESP or a CCA’s termination of service to all of its customers, however unlikely, will lead to a shortage of energy and capacity. Draft at p. 21. This concern is not justified. The Commission must recognize that even if an ESP or a CCA discontinues its retail sales operation and returns customers to the POLR, the underlying energy, RA capacity resources and RPS resources will remain available to serve these customers.

Mary Lynch, the representative of Constellation NewEnergy at the October 29 en banc hearing, emphasized that resources do not go away when and if an LSE no longer is able or willing to provide retail service to its customers. Other retail providers, including but not limited to the POLR, will be able to take assignment of these resources in order to continue service to

customers in a seamless manner. The draft Gap Analysis implicitly acknowledges this fact by noting the “disparity” between the level of resources currently held by the IOUs and the reduced IOU load resulting from expanded CCA participation. Draft at p. 35. These excess IOU resources can and should be deployed in a manner that enables other LSEs to “optimize” the use of these resources, while reducing IOUs’ stranded costs.

IV.

RELIABILITY AND PROCUREMENT

The draft Gap Analysis devotes considerable attention to “reliability and energy procurement.” Energy procurement and resource reliability are issues being addressed in several ongoing proceedings, including the RA proceeding (R.17-09-020) and the IRP proceeding (R.16-02-007). In these proceedings, the Commission is addressing how to maintain service reliability and long term contract stability in an increasingly de-centralized market. As with the other issues identified in the draft Gap Analysis, consideration of reliability issues in ongoing proceedings should not delay the expansion of direct access. In fact, expansion of direct access to include all non-residential load -- and eventually all customer load -- will provide encouragement to ESPs and CCAs to invest long term in RPS resources and RA capacity.

The draft Gap Analysis expresses concern that ESPs and CCAs do not procure capacity or RPS supplies on a long term basis. Draft at pp. 40-41. In fact, ESPs and CCAs have shown that they are currently entering into long-term contracts to meet statutory requirements. However, continued uncertainty regarding the future of direct access discourages long term contracting on the part of ESPs. Under current conditions, in which the direct access market is severely limited, an ESP does not have an incentive to contract on a long term basis for RA capacity or RPS energy, because the ESP’s potential market is restricted. An ESP has no assurance that if it loses a customer to a competitor, it can make up this loss of load by wresting another direct access eligible customer from a competing ESP or a CCA. An ESP has limited ability to acquire a “replacement” customer, or otherwise increase the size of its customer load. Lifting the cap on direct access will go a long way to enable (and encourage) ESPs -- as well as CCAs -- to invest in capacity and preferred resources on a long term basis.

Moreover, continued regulatory uncertainty discourages ESPs and CCAs from making long term investments in energy storage and generation assets. Under the RA capacity and energy storage procurement rules, ESPs and CCAs have specific energy storage and local RA capacity procurement obligations. When the Commission approves, through an advice letter process (or a one-off application), IOU procurement of energy storage and/or capacity to meet a local RA capacity requirement (and which contributes to the IOU’s energy storage procurement obligation), ESPs and CCAs that have acquired energy storage and/or local RA capacity are “long” and the value of their local RA capacity and/or energy storage is diminished.

Most recently, the Commission approved Resolution E-4949 (November 8, 2018), which approved PG&E's procurement of 567.5 MW of energy storage to meet a local RA requirement in the South Bay-Moss Landing local sub-area. The Commission approved Cost Allocation Mechanism ("CAM") treatment for this energy storage, which means that the cost of PG&E's storage will be allocated to all customers in PG&E's service territory, including direct access and CCA customers. PG&E's procurement of this energy storage also has the effect of reducing the energy storage procurement obligation of each ESP and CCA operating in PG&E's service territory.

The draft Gap Analysis complains that there has been "historical natural leaning" on IOU procurement by ESPs and CCAs. Draft at p. 41. Uncertainty regarding Commission approval of "on behalf of" procurement, however, discourages ESPs and CCAs from procuring their own RA capacity in local sub-areas. Resolution E-4949, and the Commission's repeated approval of IOU procurement of energy storage and other assets to meet local RA capacity requirements, undermines ESP and CCAs' long term energy storage (and local RA capacity) procurement efforts, and sends the wrong signal to the market.

The draft Gap Analysis improperly assumes that the Commission must establish the mix of resources to meet the State's decarbonization goals. In a direct challenge to a de-centralized competitive retail market, the draft Gap Analysis states that the Commission should "determine the best ways to deploy capital to support cost-effective investment to advance the State's GHG reduction goal." Draft at p. 7. This statement was echoed by TURN representative Matthew Freedman at the October 29 en banc hearing. Mr. Freedman suggested that the Commission should establish a central, statewide procurement entity to achieve the "optimal portfolio" of capacity and supplies for the State.

Shell Energy strongly disagrees with the draft Gap Analysis and with TURN. In a de-centralized market in which customers have many choices, it is the market, not the Commission, that decides the best ways to deploy capital to support investment in the resources required to meet the State's GHG emission reduction goals. It is the market, not the Commission, that develops the "optimal portfolio" of supplies to meet the State's decarbonization objectives. LSEs and their customers should have the flexibility and the freedom to meet the State's GHG emission reduction goals in the manner that best suits the customers' needs.

As stated so simply and eloquently by Commissioner Pat Wood at the October 29 en banc hearing, the Commission's role should be to set the requirements and then "get out of the way" to let the market work. Mary Lynch, the representative of Constellation NewEnergy, stated at the en banc hearing that customer choice is "messy." Competitive choice results in different customers making different decisions regarding the best means by which to meet their energy needs. This can and should be accomplished on a de-centralized basis. De-centralized choices lead to innovation and creative solutions, while meeting the State's decarbonization objectives.

The State's GHG emission reduction goals will be met, and reliability will be maintained, in a decentralized market. The Commission and the Legislature should establish procurement requirements and provide regulatory certainty that the rules will not change. Commissioner Wood properly noted that in those circumstances, if the penalties for non-compliance are higher than the cost to comply, LSEs will have the appropriate incentive to meet the State's decarbonization targets.

V.

“COMMAND AND CONTROL” MUST YIELD TO CUSTOMER CHOICE

One of the most troubling statements in the draft Gap Analysis (and the statement that appears to make the Commission most reluctant to open the market to competition) is that the Commission's ability to dictate IOU procurement choices and guarantee IOU cost recovery has been the primary catalyst in the development of “preferred resources.” The draft Gap Analysis states that California has been able to acquire RPS resources at such a fast pace because “contracts between developers and [the IOUs] leveraged the [IOUs'] ability to conduct competitive procurement for the lowest cost resources and to provide a creditworthy counterparty to long-term power purchase agreements.” Draft at p. 46. The draft Gap Analysis fails to recognize, however, that the IOUs' contracts with developers of preferred resources have resulted in billions of dollars of excess costs borne by California ratepayers.

The draft Gap Analysis wistfully observes that through the exercise of “command and control,” the Commission has historically relied on the IOUs (over which the Commission has jurisdiction) to finance the procurement of preferred resources and capacity (as well as energy efficiency and other behind the meter technologies), based on the assurance that any IOU contract approved by the Commission will receive guaranteed cost recovery. *Id.* The draft Gap Analysis questions how this financing mechanism can be replaced in a de-centralized market. Unfortunately, the draft Gap Analysis does not critically assess whether this IOU financing mechanism has produced the lowest possible cost for ratepayers.

The draft Gap Analysis makes the incorrect assumption that the goal of increased market competition is inconsistent with the State's “competing goals” to promote RPS procurement and increased decarbonization. The draft states that “[t]he tension between utilizing markets to achieve lower costs and state-based policy initiatives designed to foster decarbonization has to be harmonized.” *Id.*

Shell Energy does not agree with the premise that achieving lower costs through competition is inconsistent with increased decarbonization. Once the Commission (or the Legislature) establishes a requirement (e.g., RPS and energy storage procurement targets, or GHG emission reduction targets), the Commission should allow the market to respond to and comply with the requirement. ESPs and CCAs have consistently met the procurement

obligations established by the Commission. They will continue to do so as the market becomes increasingly de-centralized. Moreover, a competitive market with multiple buyers and sellers will produce lower prices than the opaque “command and control” structure that has repeatedly produced overpriced IOU contracts for RPS energy and RA capacity over the past decade.

Finally, the draft Gap Analysis suggests that the Commission should examine a “central procurement entity” and/or “coordinated multi-party procurement” as alternative means by which to ensure long term procurement of capacity and preferred resources that are necessary to meet reliability and decarbonization goals. Draft at pp. 49-50. The Commission is already examining the role of a central procurement entity in the RA proceeding. This inquiry is not a justification to delay expansion of customer choice.

Moreover, coordinated multi-party procurement can be achieved organically through commercial arrangements, rather than through a mandate imposed by the Commission. As noted above, if the Commission is committed to establishing a long-term capacity procurement obligation, the Commission should be equally committed to avoiding regulatory actions that undermine LSEs’ long-term contracting for energy storage, RPS, and RA capacity.

VI.

CONCLUSION

Shell Energy appreciates the opportunity to present these comments on the draft Gap Analysis. At the earliest possible opportunity, the Commission should institute a new OIR proceeding to implement SB 237.

Respectfully submitted,



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